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***October 24, 2001***

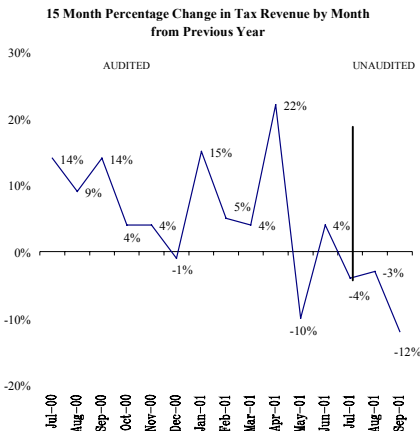
***To the Citizens of the Commonwealth of Massachusetts,  
Governor Jane Swift, and Honorable Members of the General  
Court***

I am pleased to report that as of June 30, 2001, the financial condition of the Commonwealth remains sound, however the picture is changing. Since FY94 this office has reported that the fiscal health of the Commonwealth is strong. The Commonwealth has enjoyed over seven years of prosperity and growth. The Commonwealth's unemployment level shrunk during the time period by 42% from 205,000 citizens unemployed in 1994 to 86,000 in 2000. At some point the economy had to slow down. As of June 30, 2001, the Federal Reserve Bank of Boston, in its monthly "New England Economic Indicators," reports that the number unemployed in our Commonwealth has increased to 113,000, or a rate of 3.4%. This rate is under the "full employment" threshold of 5%, but it is rising. The same report shows that the consumer confidence index has slipped in our Commonwealth from a rate of 156 a year ago, to 108 today, with future expectations lower. This softening economy is reflected in tax receipts for the first quarter of FY02. Tax revenues are \$202 million below amounts assumed in the Governor's budget recommendation and reflect a real decline from the same period last year.

Fortunately, prudent planning throughout the 1990s has left the Commonwealth well positioned for this economic slow down. The Commonwealth ends FY01 with a \$3 billion surplus in its budgeted funds. Since FY91, the Commonwealth's Stabilization Fund, sometimes called the "rainy day fund," has grown from a balance of \$59 million to over \$1.7 billion, its maximum. In addition, in the final set of appropriation acts for the fiscal year, the Commonwealth set aside over \$579 million in FY01 surpluses to be appropriated no later than November 30, 2001.

The Stabilization Fund is a strategic tool at decision makers' disposal to assist the Commonwealth through this difficult time. It may be used in three circumstances. The first is to make up any difference between the actual state revenues and the allowable state revenues in the case of a revenue shortfall. The second is to replace federal funds in the case of a shortfall. Finally, the fund may be used for any event that threatens the health, safety, welfare, or stability of the Commonwealth, including an economic downturn. The challenge is to use it wisely to help the Commonwealth transition to this new economic reality, not delay necessary changes that must be made.

In previous years, year-end transfers of budget surpluses were made to the capital project funds to make strategic investments for the management of the Commonwealth's capital budget, to defease high



interest debt that otherwise could not be refunded, and continue to increasing reserves.

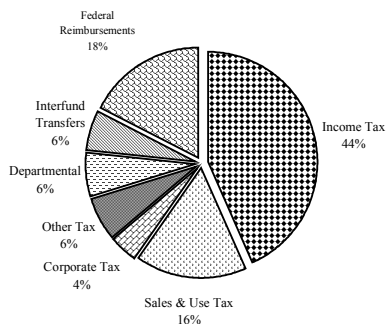
In accordance with Massachusetts General Laws, the Office of the Comptroller transmits the Statutory Basis Financial Report (SBFR) on or before October 31<sup>st</sup>. The SBFR report for fiscal year ended June 30, 2001 (FY01) herein is audited by Deloitte & Touche, Independent Certified Public Accountants, and represents the conclusion of financial activity and the closing of the Commonwealth's books on the statutory basis of accounting for the fiscal year. This audit is conducted in conjunction with the Office of the State Auditor, which provides knowledge, expertise and resources to close and audit the financial statements.

This report includes the budgeted funds, non-budgeted special revenue funds, capital project funds, fiduciary funds and the non-appropriated funds of higher education.

The financial operations of these funds are maintained in the Massachusetts Management Accounting and Reporting System, (MMARS). The statewide accounting system is operated by the Commonwealth and contains detailed information summarized in this report.

The SBFR is intended to satisfy the requirements of state finance law, and to present fairly the results of FY01 activity in the Commonwealth's funds. The report contains computations required by state finance law, including the certification of the Stabilization Fund and Tax Reduction Fund. The statutory basis of accounting, defined in Massachusetts law, is typically used to budget and control fiscal operations. The statutory basis of accounting is not in conformity with accounting principles generally accepted in the United States of America, (GAAP) as defined for governments by the Government Accounting Standards Board (GASB.) I will report the Commonwealth's financial position on a GAAP basis in December, in our Comprehensive Annual Financial Report, (CAFR.)

### ***Budgeted Revenues and Other Sources***



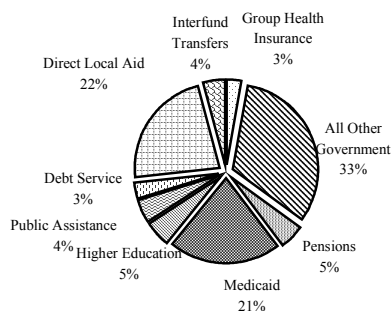
### ***Budgeted Funds***

For fiscal 2001, sources of budgeted funds exceeded uses of budgeted funds, resulting in an operating surplus of \$726 million. This surplus is net of \$34 million transferred to fund future capital projects.

More importantly, any surplus or deficit has to be viewed in a trend. Generally accepted standards indicate that a structural balance is achieved when revenues exceed expenditures over a period of multiple years. Before one-time uses of surpluses, the Commonwealth has over a decade-long record of operating gains. The \$34 million transferred for capital outlays allow the Commonwealth to issue fewer bonds in the future to pay for capital costs. The \$624 million transferred for defeasance allows the Commonwealth to pay less in the future for capital costs already bonded. This is sound fiscal policy.

In FY01, budgeted revenues and other sources grew 1.2% over FY00 reflecting a “leveling off” economy, the phase-in of the reduction of the income tax, and subsidies to the MBTA along with related financing sources being moved “off budget.” Budgeted tax revenue (adjusted for the change in funding related to the MBTA) increased by 6.6% over FY00. These are compared to 12% gains in budgeted revenues and 9.8% gains in tax revenues during FY00 from FY99. From a multi-year perspective, the proportion of revenue sources by category to total budgeted revenues and other sources did not materially change from FY00 to FY01. Personal income, sales and corporate taxes continue to be the three largest sources of tax revenue for the Commonwealth.

### ***Budgeted Expenditures and Other Uses***



Budgeted expenditures and other uses, including transfers, decreased 1.2% from FY00 to FY01. This decrease is the result of subsidies to the MBTA that were moved off budget, \$600 million in one time savings related to defeasance of high interest debt and the deficit elimination within the Highway and Local Aid Funds performed only in FY00. The Budgeted Funds – Operations table on page 4 displays the FY01 summary of budgeted funds, compared to FY00. Financial statements for each of the 57 individual budgeted funds are included in the financial section of this report.

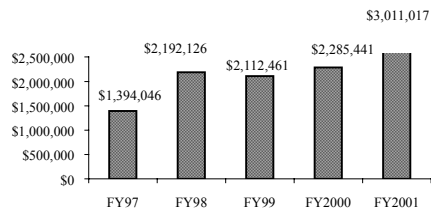
In conducting the budget process, the Commonwealth excludes those “interfund” transactions within the budgeted funds that, by their nature, have no impact on the combined fund balance of the budgeted funds. The table isolates this “interfund” activity from the budgeted sources and uses to align forecasts prepared during the budget process to actual amounts in this report. For example, the Budgeted Funds – Operations table on the following page, in previous years isolated the assessments on municipalities collected by the Commonwealth and paid to the MBTA and regional transit authorities. The effect of Forward Funding the MBTA and other measures reduced these transfers by nearly \$3 billion this year. A detailed list of these interfund transfers is included in note 3 to the general purpose financial statements.

The graph of Budgeted Funds – Fund Balance, on page 5, shows the combined fund balance in the budgeted funds for the past five years. This “bottom line” perspective demonstrates the accumulation of resources attributable to balanced budgets over this period. The FY01 ending balance of \$3 billion is composed of three items. The aforementioned Stabilization Fund balance of \$1.7 billion is the largest component. The other components include \$367 million undesignated.

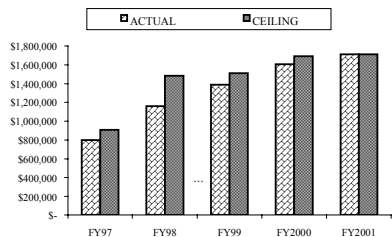
**Budgeted Funds - Operations**  
**(Amounts in thousands)**

	<u>2000</u>	<u>2001</u>
Beginning fund balances:		
Reserved and designated.....	\$ 330,227	\$ 278,526
Reserved for Tax Reduction .....	6,818	7,203
Reserved for Stabilization Fund.....	1,388,523	1,608,382
Undesignated.....	<u>386,893</u>	<u>391,330</u>
Total.....	<u>2,112,461</u>	<u>2,285,441</u>
Revenues and other sources:		
Taxes.....	15,688,616	16,074,655
Federal reimbursements.....	3,645,550	3,974,158
Departmental and other revenues.....	1,359,918	1,431,831
Interfund transfers from non-budgeted funds and other sources.....	<u>1,893,004</u>	<u>1,385,884</u>
Budgeted revenues and other sources.....	<u>22,587,088</u>	<u>22,866,528</u>
Mass transit assessments.....	15,821	-
Intragovernmental Service Fund revenues.....	99,663	108,527
Interfund transfers among budgeted funds and other sources.....	<u>3,518,530</u>	<u>822,486</u>
Total revenues and other sources.....	<u>26,221,102</u>	<u>23,797,541</u>
Expenditures and other uses:		
Programs and services.....	19,330,674	19,474,333
Debt service.....	1,193,329	675,939
Pension.....	986,303	1,040,121
Interfund transfers to non-budgeted funds and other uses.....	<u>903,802</u>	<u>950,559</u>
Budgeted expenditures and other uses.....	<u>22,414,108</u>	<u>22,140,952</u>
Payments of mass transit assessments.....	15,821	-
Intragovernmental Service Fund expenditures.....	99,663	108,527
Interfund transfers among budgeted funds and other uses.....	<u>3,518,530</u>	<u>822,486</u>
Total expenditures and other uses.....	<u>26,048,122</u>	<u>23,071,965</u>
Excess of revenues and other sources over expenditures and other uses.....	<u>172,980</u>	<u>725,576</u>
Ending fund balances:		
Reserved and designated.....	278,526	895,305
Reserved for Tax Reduction .....	7,203	33,565
Reserved for Stabilization Fund.....	1,608,382	1,714,990
Undesignated.....	<u>391,330</u>	<u>367,157</u>
Total.....	<u>\$ 2,285,441</u>	<u>\$ 3,011,017</u>

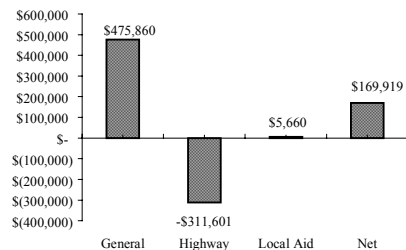
***Budgeted Funds – Fund Balance  
(Amounts in Thousands)***



***Stabilization Fund  
Fund Balance  
(Amounts in Thousands)***



***“Consolidated Net Surplus”  
Prior to Transfers  
(Amounts in Thousands)***



surplus available for appropriation in FY01 and \$895 million reserved and designated for continuing appropriations, transitional escrow and debt service. With the current state of the economy, we now realize the importance of the balance in the Stabilization Fund and its direct correlation to the positive financial condition of the Commonwealth. State finance law, as amended during FY98, increased the maximum balance that may accumulate in the fund to a level of 7.5% of budgeted revenues and other sources. The law then directs that any amount in excess of this “cap” be transferred to the Tax Reduction Fund for future, one-time, personal income tax rebates. In FY01 with a deposit of \$51 million this cap of \$1.7 billion has been reached. \$30 million in excess of the cap has been deposited in the Tax Reduction Fund. The details of these calculations can be found on page 318 of this report.

The graph, Stabilization Fund Balance portrays this “cap” and the balance of the fund over a five-year period. Despite the Commonwealth’s positive financial condition, a few cautionary notes are merited. There are certain problems with the definitions in the state finance law, enacted in 1986 and continued with slight modifications to the present. A balanced budget, defined as the “Consolidated Net Surplus,” is the combined undesignated fund balance of the General, Local Aid, and Highway Funds. According to this restricted definition, fiscal balance was achieved in FY01 in the amount of \$170 million. However this definition excludes 52 other budgeted funds with combined undesignated fund balances of over \$283 million plus reserves for continuing appropriations. The Commonwealth should adopt a more straightforward definition of fiscal balance. State finance law should be amended to rationalize the contributions to the Stabilization Fund to include the entire population of budgeted funds.

Under current general laws, an amount equal to 0.5% of tax revenues is retained in the funds contributing to the calculation. Any amount in excess of this is available for transfer from the General and Local Aid funds to the Capital Projects Fund in lieu of bonds, and the balance is transferred to the Stabilization Fund. In FY01, \$34 million was transferred for capital projects with the remaining balance transferred to the Stabilization Fund.

Further complicating this issue is the existence of a large number of “minor” budgeted funds. Over the past several years, dozens of new “minor” funds have been created. These funds split off revenues and expenditures previously accounted for as part of a major fund, such as the General Fund. A number of these funds have structural imbalances leading to chronic deficits. The trend to fragment the budget into such special interest funds should be addressed with a plan to either consolidate to a more reasonable number of funds or eliminate funds that are structurally in deficit.

### ***Non-Budgeted Funds***

The Non-Budgeted Funds represent operations in which the government has imposed its sovereign authority, but has excluded these operations from the annual budget process. During FY01, the Commonwealth maintained 31 of these funds. The largest funds in activity include the Lottery, Federal Grants, Debt Defeasance, Health Care Security Trust (the recipient of tobacco settlement funds), Grant Anticipation, Sewer Rate Relief, the Medical Security Trust and the Uncompensated Care Funds. These funds are commonly referred to as special or dedicated revenue funds whose revenues are matched to related expenditures.

The table, Non-Budgeted Funds – Operations, includes a summary of the FY01 non-budgeted funds. Financial statements for each of the individual funds are included in the financial section of this report. Several of these funds are worth mentioning. At June 30, 2001, the Federal Grants Fund had a positive fund balance, but there is a deficiency in cash within the fund. This situation results in the Commonwealth drawing funds from the federal government a few days after applicable cash disbursements to assure an “interest neutral” timing of the federal – state cash exchange. These requirements were established by the Cash Management Improvement Act of 1990. Within the Lottery Funds, gross revenues continued to increase this fiscal year. However, due to legislation passed advancing Cities and Towns an extra payment during the fiscal year, to be netted out of the December 2001 quarterly payment, the State Lottery Fund has a deficit of nearly \$12 million.

#### **Non-Budgeted Funds - Operations (Amounts in thousands)**

	<u>2000</u>	<u>2001</u>
Beginning fund balance.....	\$ 903,017	\$ 1,089,430
Revenues and other sources:		
Taxes.....	13,553	678,205
Assessments.....	378,364	492,914
Federal grants and reimbursements.....	2,076,386	2,142,304
Tobacco Settlement Revenue.....	326,235	242,470
Departmental and miscellaneous.....	4,355,279	4,642,096
Transfers and other sources.....	<u>1,008,248</u>	<u>994,328</u>
Total revenues and sources.....	<u>8,158,065</u>	<u>9,192,317</u>
Expenditures and other uses:		
Programs and services.....	5,694,496	6,426,228
Debt service.....	43,686	62,692
Transfers and other uses.....	<u>2,233,470</u>	<u>2,907,546</u>
Total expenditures and uses.....	<u>7,971,652</u>	<u>9,396,466</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	<u>186,413</u>	<u>(204,149)</u>
Ending fund balance.....	<u>\$ 1,089,430</u>	<u>\$ 885,281</u>

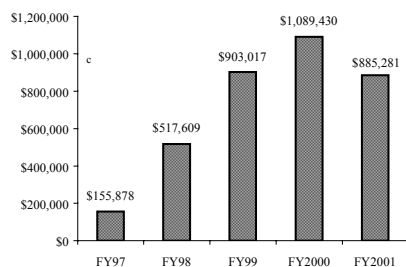
The Health Care Security Trust Fund receives all revenues from the Master Settlement Agreement (MSA) between the states and the tobacco industry to recover healthcare costs for tobacco related illnesses. The MSA estimates the Commonwealth revenues for the first 25 years of the settlement to be approximately \$7.6 billion. However, this estimate is prior to future adjustments including adjustments for inflation and changes in the volume of domestic cigarette sales. In FY01, the Commonwealth received over \$242 million or 87% of the estimated amounts shown in the agreement. Of the \$242 million, nearly \$82 million was transferred to the Tobacco Settlement Fund, a budgeted fund. The majority of expenditures from the fund this year were for Health and Human Services, Elder Affairs and Medicaid costs.

Beginning in FY01, a board of public and private sector investment experts, appointed by the Governor, the Attorney General and the Treasurer-Receiver-General, will manage the investment of funds in the trust. This board has broad discretion on investment choices to increase the assets in the fund. Annually, 30% of payments into the fund and investment earnings thereon will be transferred from the trust to the budgeted funds for appropriation by the Legislature. This board has decided to leverage the experience and the economies of scale of the Pension Reserves Investment Trust while actively managing the asset allocation.

Federal Grant Anticipation Notes, (GANS) activity related to the Central Artery / Tunnel Project (CA/T) continued this year. During FY98, the Legislature authorized the issuance of up to \$1.5 billion in GANS to finance the current cash needs of the Project. As of June 30, 2001, all of the GANS have been issued. These GANS mature between 7 to 17 years from the date of issuance and are redeemed by pledged future federal reimbursements. The GANS are not considered general obligation debt of the Commonwealth. Activity related to issuance of GANS and the accumulation of pledged funds and the payment of debt service is accounted for in the Grant Anticipation Note Trust Fund. The \$124 million surplus in FY01 represents \$83 million held for payment of interest on the GANS and \$41 million in cash from the GANS issuance that will be expended on the construction of the CA/T.

The universal health care funds, including the Uncompensated Care, Labor Shortage and Medical Security Trust Funds, have increased their annual revenue to over \$1.1 billion. They also have a combined fund balance of over \$241 million.

***Non-Budgeted Funds –  
Fund Balance  
(Amounts in Thousands)***



The graph Non-Budgeted Funds Balance shows the combined fund balance in the Non-Budgeted funds for the past five years. In each year, the entire balance is designated for the specific purpose of the fund. The overall growth in fund balance in these funds this fiscal year is due largely to deposits into the Debt Defeasance and Health Care Security Trust Funds. The GANS fund had a net deficit balance in FY01 due to timing. As indicated in previous years, more consolidation and elimination is needed for these funds. For example, the Government Land Bank Fund has a chronic structural fund deficit.

The FY01 deficit balance of \$35 million represents an unbudgeted drain in cash flows in the General Fund. While steps have been taken to stop the growth in this deficit, the Fund should be abolished and the deficit transferred into the General Fund. An additional deficit exists in the Motor Vehicle Inspection Fund. However, the enabling statute to the Fund mandates that the Fund must be in balance by June 30, 2005. A periodic re-examination of all non-budgeted funds represents sound financial practice.

### ***Capital Projects Funds***

The purpose of these funds is to construct or acquire capital assets for governmental use. The Governor may propose capital outlay budgets, which, upon enactment by a two-thirds vote of the Legislature and approval by the Governor, become capital outlay acts. Numerous acts may be combined for reporting in an individual Capital Project Fund, but each act is accounted for separately within the Capital Projects Fund. These accounts record authorizations for expenditures in itemized capital appropriation accounts and equivalent authorizations to issue bonds or notes in anticipation of federal reimbursements.

The structure of these funds is that each capital outlay authorization is in balance, creating authorization for inflows, which may be from sales of bonds, federal reimbursements or other revenues and authorization for expenditures. Imbalances due to timing differences develop when the expenditure precedes the inflow of funds from the sale of bonds or federal reimbursements. Because of federal tax arbitrage rules, it is more difficult to sell bonds in anticipation of expenditures. The sale of bonds in advance is not commonplace in the Commonwealth.

However, six series of bonds were sold this year in advance, both funding the CA/T. The Commonwealth sold variable rate demand bonds and auction rate securities in these transactions totaling approximately \$677 million. In addition, \$400 million of notes were also sold in advance to help finance the Convention Center Project in South Boston.

The variable rate demand bonds and auction rate securities funded a significant portion of the Capital Projects activity relating to the CA/T. The CA/T has been the target of an enormous amount of public scrutiny. As indicated in the footnotes to the General Purpose Financial Statements, the financial disclosure portion of the project is under review with various federal agencies. The Commonwealth has aggressively responded to these concerns regarding the integrity of the cost estimates. For the second year, an independent evaluation of the entire estimate for the project has been undertaken. In the proposed finance plan released August 31, 2001, the cost of the project has risen \$400 million to \$14.475 billion. It is important to note that the federal government has capped its contribution to this project and the finance plan includes state sources to fund this increase. The plan also reported that the project is over 69% complete.

### ***Central Artery / Tunnel Project (Amounts in Billions)***

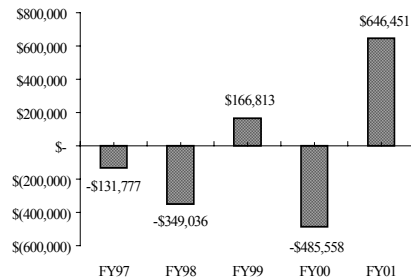
<b>Sources of Funds:</b>	<u>2000</u>	<u>2001</u>
Federal Funds	\$ 7.049	\$ 7.049
GANS	1.500	1.500
Massachusetts Turnpike Authority	1.793	1.706
Massachusetts Port Authority	0.365	0.300
Other Commonwealth Debt	2.815	3.077
Commonwealth Operating Funds and Investment Earnings	<u>0.553</u>	<u>0.843</u>
<b>Total Sources</b>	<u>\$ 14.075</u>	<u>\$ 14.475</u>
<b>Costs of Construction:</b>		
Actual Costs through end of FY	\$ 9.122	\$ 10.425
Estimated Spending:		
FY01	1.744	-
FY02	1.371	1.472
FY03	0.940	1.122
FY04	0.658	0.985
FY05	0.240	0.336
FY06	<u>-</u>	<u>0.135</u>
<b>Total Estimated Costs of Construction:</b>	<u>\$ 14.075</u>	<u>\$ 14.475</u>

During FY00, the Commonwealth put in place a new management team for the project that is committed to full, timely disclosure about schedules and costs. The bulk of the spending remaining on the Project and will occur during FY02 and FY03. Completion is expected to be during FY06. However, a leak has developed in the tunnel sections of Interstate 90 under the Fort Point Channel in Boston. As of October 1, 2001, the estimate of the opening of this phase of the project has been pushed back at least two months, from September 2002 to November of 2002, at the earliest.

Pursuant to statute and agreements with the Massachusetts Turnpike Authority (the MTA) and the Massachusetts Port Authority (MassPort), the entities have committed to significant ongoing contributions to the Commonwealth as part of the financing for this project. These funds are in addition to funds from the Commonwealth and federal funds for the project.

Finally, the Highway Capital Projects Funds will continue to show a deficit for the foreseeable future. That fund's deficit will be amortized through FY20 to pay for the MBTA Forward Funding, unless otherwise bonded for.

***Capital Projects Funds –  
Fund Balance (Deficit)  
(Amounts in Thousands)***



The graph Capital Projects Funds – Fund Balance (Deficit) shows the combined fund balance in Capital Projects Funds for the past five years. The graph shows a surplus in the funds in FY01 due to the bonding in advance for the CA/T completed this year.

The Capital Projects Funds – Operations table on the next page, includes the FY01 Capital Projects Funds, summarized and compared to FY00. Financial statements for each of the individual funds are included in the financial section of this report.

The Administration has implemented a coordinated fiscal strategy for the management of Capital Projects Funds. This strategy includes a five-year capital budget linked to debt management and cash management. The focus of this strategy is to manage capital spending and outstanding debt to levels the Administration considers appropriate for the Commonwealth. An important part of the strategy is to control capital spending within an annual administrative “cap.” As additional capital outlays have been enacted and significant projects such as the CA/T have been authorized, it becomes more challenging to restrain spending to such limits. Strategies to manage this situation, such as alternative financing for capital projects, are needed. The MTA and Massport’s participation in the CA/T and the judicious use of operating surpluses should continue.

**Capital Projects Funds - Operations**  
**(Amounts in thousands)**

	<u>2000</u>	<u>2001</u>
Beginning fund balance (deficit).....	\$ 166,813	\$ (485,558)
Revenues and other sources:		
Federal grants and reimbursements.....	2,529	1,035
Departmental and miscellaneous.....	11,199	64,262
Payment from Authorities.....	152,438	265,000
General obligation financing.....	1,761,621	1,911,676
Proceeds of refunding bonds.....	-	998,729
Transfers from budgetary surplus.....	76,581	34,462
Transfer for Capital Projects Funds.....	128,977	-
Transfer for Federal Reimbursements.....	484,187	458,659
Transfer from Transitional Escrow.....	16,800	-
Transfer in due to debt defeasance .....	-	624,589
Transfers and other sources.....	<u>1,276,718</u>	<u>1,166,878</u>
Total revenues and other sources.....	<u>3,911,050</u>	<u>5,525,290</u>
Expenditures and other uses:		
Acquisition of assets.....	2,918,180	2,663,464
Payments to refunded bond escrow.....	-	998,729
Transfer for debt defeasance.....	150,000	-
MBTA Forward Funding Transfer.....	612,750	-
Transfers and other uses.....	<u>882,491</u>	<u>731,088</u>
Total expenditures and other uses.....	<u>4,563,421</u>	<u>4,393,281</u>
Excess (deficiency) of revenues and other sources over expenditures and uses.....	<u>(652,371)</u>	<u>1,132,009</u>
Ending fund balance (deficit).....	<u>\$ (485,558)</u>	<u>\$ 646,451</u>

The reductions in debt service from budgeted fund balance transfers for defeasance will be used, in part, to fund an initiative from FY02 through FY06 to rehabilitate the Commonwealth's road and bridge infrastructure. According to Massachusetts Highway Department statistics, during the last eight years, road and bridge construction projects statewide totaled over \$5 billion in spending, exclusive of the CA/T. Also, according to the Highway Department, road and bridge construction statewide was \$577 million in FY01, compared to an average of \$395 million in spending per year from FY89 to FY93. The financing plan increases this average, exclusive of the CA/T, for the next five years.

The Commonwealth also completed during August 2000, the financing of lease revenue bonds in connection with the Route 3 North Project, a long – neglected, narrow and congested highway from the New Hampshire border to Route 128 / 95 in Burlington. This financing is the first of its kind in the Commonwealth. A nonprofit corporation has been created to accept lease payments from the Commonwealth and award a singular contract to a development team to design, build, and potentially maintain the highway. When the project is completed in late FY04, estimated travel times are expected to be reduced in a 12-mile stretch of the road from 40 minutes to 15 minutes.

### ***Fiduciary Funds (Excluding Agency Funds)***

The Fiduciary Funds record the Commonwealth's responsibility for assets it controls on behalf of other parties. Examples of such funds are the Unemployment Compensation and Pension Trust Funds. The table on the following page, which excludes assets held on a purely custodial capacity in so-called Agency Funds, summarizes the FY01 activity of the Fiduciary Funds. Over 92% of this Fiduciary Fund activity is related to the Commonwealth's Pension Fund detailed in fund statements found in this report.

On September 19, 2001, the Commonwealth updated its pension valuation. The valuation was based on data as of January 1, 2001. Details of this valuation are outlined in note 10. While the value of pension assets has dropped 2.7% since this valuation, the public retirement system remains strong at 82.7% funded.

#### **Fiduciary Fund - Operations (Excluding Non-Expendable Trusts) (Amounts in thousands)**

	2000	2001
Beginning fund balance.....	\$ 28,387,447	\$ 32,860,778
Revenues and other sources:		
Taxes.....	861,843	894,161
Federal reimbursements.....	31,481	41,253
Departmental and other revenues.....	1,551,987	1,701,987
Interfund transfers and other sources.....	21,587	24,649
Unrealized and realized investment earnings / (losses).....	4,480,252	(1,819,686)
Total revenues and sources.....	6,947,150	842,364
Expenditures and other uses:		
Expenditures.....	2,407,771	2,653,885
Interfund transfers.....	66,048	91,693
Total expenditures and uses.....	2,473,819	2,745,578
Excess (deficiency) of revenues and sources over expenditures and uses.....	4,473,331	(1,903,214)
Ending fund balance.....	\$ 32,860,778	\$ 30,957,564

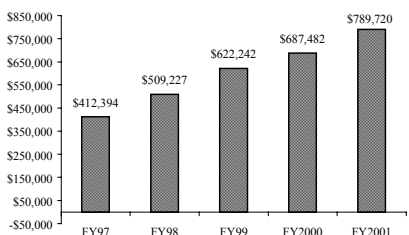
## ***Non-Appropriated Funds of Higher Education***

The SBFR includes the financial operations of the non-appropriated funds of the 25 Institutions of Higher Education in the statistical section of this report. Over the past few years, significant efforts have been taken by our office and the institutions to improve the accuracy and timeliness of this Higher Education segment of the financial report. Each Institution of Higher Education is authorized and directed in its enabling statute to collect, retain and expend certain fees, rents, sales, donations, federal financial participation and other types of revenue through campus based systems. These financial resources are integral parts of the total financial activity of each campus. They also represent resources in addition to amounts made available from Commonwealth appropriations.

### **Non-Appropriated Funds Of Higher Education - Operations (Amounts in thousands)**

	2000	2001
Beginning fund balance.....	\$ 622,242	\$ 687,482
Revenues and other sources:		
Federal Grants and reimbursements.....	208,573	235,733
Departmental and miscellaneous.....	1,067,601	900,245
Transfers and other sources.....	100,476	402,061
Total revenues and other sources.....	1,376,650	1,538,039
Expenditures and other uses:		
Programs and services.....	1,202,371	1,032,347
Transfers and other uses.....	109,039	403,454
Total expenditures and uses.....	1,311,410	1,435,801
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	65,240	102,238
Ending fund balance.....	\$ 687,482	\$ 789,720

### ***Non-Appropriated Funds of Higher Education – Fund Balance (Amounts in Thousands)***



The Non-Appropriated Funds for Higher Education – Operations table includes the FY01 funds, summarized and compared to FY00. Financial statements for each of the individual funds are included in the statistical section of this report. The graph Non-Appropriated Funds for Higher Education – Fund Balance shows the combined fund balance for the past five years. The combined balance represents \$643 million for the University of Massachusetts, \$80 million for the State College system and \$67 million for the Community Colleges. These balances are designated for specific purposes, such as restrictions on endowments or other specialized purposes specified by the funding contributions.

## ***Conclusions And Recommendations***

The Commonwealth has many accomplishments in FY01 of which it can be proud.

The Office of the Comptroller has undertaken a major effort to build a more collaborative working relationship among members of this office and Chief Fiscal Officers (CFO) of the Commonwealth. For the first time, the Commonwealth held a CFO conference bringing together CFOs from across the Commonwealth for two days of meetings. There, I introduced the concept of PARTNERS as way to communicate, solidifying our Office's relationship with the rest of the Commonwealth's CFOs. PARTNERS stands for people, accountability, responsibility, trust, negotiation, efficiency, risk assessment and mitigation, and solutions. We have enhanced the mantra that all systems, big and small, depend on people who are integral to those systems. As fiscal officers of the Commonwealth, we are all accountable for our actions, ensuring the uncompromising integrity of the financial statements of the Commonwealth. We must maintain this standard to maintain the public trust. We have introduced more delegation this year to individual departments due to the level of trust that we have between them, based on prior results. This delegation, was the result of intense negotiation between our Office, other central service offices, and the CFO's. We must continually strive to balance accountability with efficiency, especially in order to continually serve the Citizens of the Commonwealth, our customers. This balancing also targets controls to result in effective risk mitigation. Finally, we strive to find solutions to many of the Commonwealth's problems in conjunction with the rest of the CFOs, so that full input is heard.

This year, the Commonwealth has started the process of consolidating its web sites to better serve the Citizens of the Commonwealth. With service to our customers as key, the Commonwealth's new web portal "Mass.Gov" promises to bring government closer to the people. Mass.Gov will be customer-focused. It will provide services according to the needs of citizens and businesses, not according to government structure. Citizens will be able to quickly find the information and services they need without having to navigate the bureaucracy of government. Mass.Gov will provide comprehensive, integrated, and seamless services that our Citizens will be able to bring into their homes or businesses at their convenience, twenty-four hours a day, seven days a week. An element of Mass.Gov is the successful massfinance.com web site that our Office hosts. Vendors of the Commonwealth can view at a moment's notice what is being paid to them, from what agency and when. Furthermore, our electronic funds transfer (EFT) campaign is in full swing. Every EFT generated by the Commonwealth saves the Commonwealth 45¢ in processing costs, saving millions of dollars a year. We are also migrating to "web" distributed pay advices for our employees, saving thousands a year in production and transportation costs.

All of this falls under the concept raised in the question "what can we do better, more efficiently, at lower cost?" The Management for Results Initiative, (MRI,) is the process of examining every facet of Commonwealth government, with the goal of better serving the needs

of our Citizens without additional funds, without a decrease in level of service.

Building upon the observations of this letter, a detailed review of these financial statements suggests the need for action to further improve and strengthen state finance law and fiscal practice.

**The Commonwealth must define the term “Chief Fiscal Officer” in law.** Central to our partnership with CFO’s is ensuring they are empowered to do the job we ask of them. Too often, a department’s chief fiscal officer is not directly accountable to the chief executive officer of the department. Too often, the CFO does not have the proper functions reporting to them, enhancing internal controls. We will work to pass legislation strengthening the CFO’s role.

**The Commonwealth must constantly monitor and update its systems and controls.** Upon taking office 30 months ago, I began a multi-year effort to expand awareness of and the quality of internal controls throughout the Commonwealth. We have asked each department, at its highest levels, to assess its risks and target controls to manage those risks efficiently and effectively. Toward this end, the Office of the Comptroller has continued a multi-pronged effort to improve controls throughout the Commonwealth. This effort must continue.

**The Commonwealth must ensure that its bills are paid on time.** A solid reputation of timely bill payments benefits both our business partners and the taxpayers. During FY00, this office began a campaign with the Chief Fiscal Officers in the 154 state departments to improve the percentage of bills paid within 30 days. The timing and focus on bill paying improved the Commonwealth’s bill payment track record this year to 84% of all bills paid within 30 days. This effort will continue until we have reached and maintained a 95% level.

***Minor Budgeted Funds with Deficits  
(Amounts in Thousands)***

Environmental Funds:	
Natural Heritage and Endangered Species Fund.....	\$ (9)
Mosquito and Greenhead Fly Control Fund.....	(2,305)
Environmental Challenge Fund.....	(2,794)
Toxic Use Reduction Fund.....	(7,686)
Environmental Permitting and Compliance Assurance Fund.....	(43,155)
Underground Storage Tank Petroleum Product Cleanup Fund.....	(13,920)
Environmental Law Enforcement Fund.....	(3,875)
Public Access Fund.....	(296)
Harbors and Inland Waters Maintenance Fund.....	(7,599)
Marine Fisheries Fund.....	(5,330)
Watershed Management Fund.....	(4,331)
Low-Level Radioactive Waste Management Fund.....	(505)
Clean Air Act Compliance Fund.....	(1,048)
Second Century Fund.....	(3,594)
Child Support Penalty Fee Fund.....	(87)
Ponkapog Recreational Fund.....	(5)
Leo J. Martin Recreation Fund.....	(179)
Subtotal Environmental Fund Group.....	\$ (96,718)
Children's and Seniors' Health Care Assistance Fund.....	
Transitional Aid to Needy Families Fund.....	(13,197)
Anti-trust Law Enforcement Fund.....	(11,197)
Victim and Witness Assistance Fund.....	(2,765)
Victim and Witness Assistance Fund.....	(10,335)
Intercity Bus Capital Assistance Fund.....	(6,070)
Local Consumer Inspection Fund.....	(574)
Subtotal Budgeted Other.....	(44,138)
Total Minor Budgeted Funds with Deficits .....	<u>\$ (140,856)</u>

**The Commonwealth should adopt a more straightforward definition of fiscal balance including all of the budgeted funds.** The idiosyncratic definition of fiscal balance that includes a portion of fund balance within three of the 57 budgeted funds should be expanded to include all 57 funds.

**The Commonwealth should reduce the number of funds and eliminate funds that have chronic deficits.** The Commonwealth currently maintains over 122 individual funds to record its financial activity. This excessive number of funds fragments the Commonwealth’s financial picture. Many of these funds have structural imbalances leading to chronic deficits. The effort to reduce the number of funds should continue. A fund should be a self balancing set of accounts where decision makers want to set aside a specific set of revenues to fund a specific set of activities. Nineteen of the 57 budgeted funds are in the environmental fund group. Fifteen of these nineteen funds contribute to accumulated deficits of \$96.7 million in this fund group. The revenues and expenditures in these funds should be brought into alignment either through increased fees and assessments or decreases in appropriation, otherwise we should acknowledge that these services are to be funded from general tax revenues and consolidate this activity into the general fund. The table, Minor

Budgeted Funds with Deficits, identifies funds with significant deficits that remained unfunded or continued to grow during FY01 or where no plan exists to bring them into balance. It is important to note that the funds to finance these deficits are parked in surpluses in other funds and cannot be used without first identifying a financing source for these deficits. The structure of these funds should be changed to balance revenues with expenses or the funds should be eliminated and their activity consolidated into the General Fund.

**The management of the spending to the administratively capped debt limit should continue.** The Commonwealth has committed to an extensive capital projects agenda and great discipline will be needed to assure spending on these projects is matched with financing from bonds, federal reimbursement, transfer of budgetary surplus and financial participation from component units. Assuring proper balance between outflows and inflows, and limiting the segment funded by bonds to the administratively imposed limit, will be a major challenge.

**The Commonwealth should adopt a more streamlined approach to capital budgeting and spending.** Like the debt limit cap, the Commonwealth has a capital-spending cap, currently at \$1.15 billion per year. The transactions involved with capital budgeting and spending are interpretation as to which category of spending is actually going on. The Fiscal Affairs Division, the Secretary for Administration and Finance and various capital-intensive departments to come up with a more straightforward capital spending methodology.

**The Commonwealth should continue to emphasize optimization of both tax and non-tax revenues.** This statewide campaign has generated nearly \$244 million in revenues since FY96. The revenue optimization strategy should continue.

I again would like to express my thanks to the many dedicated people within the Office of the State Comptroller. We have had another successful year within the office. Our office has undertaken many tasks this year. As we go forth into FY02, we are embarking on the redesign of our separate Comprehensive Annual Financial Report due to GASB Statements 34, 35, 37 and 38. We are also investigating a potential upgrade to MMARS. I am proud to have all the 115 employees of the Comptroller's Office on my team to help tackle these and other difficult issues of the future.

Respectfully submitted,

Martin J. Benison  
Comptroller of the Commonwealth